

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of

Review of Section 251 Unbundling	)	
Obligations of Incumbent Local	)	CC Docket Number 01-338
Exchange Carriers	)	
	)	
Implementation of the Local	)	
Competition Provisions of the	)	CC Docket Number 96-98
Telecommunications Act of 1996	)	
	)	
Deployment of Wireline Services Offering	)	CC Docket Number 98-147
Advanced Telecommunications Capability	)	

Comments of

Hugh Carter Donahue, Ph.D.  
3003 Foxx Lane  
Philadelphia, Pennsylvania 19144

## **Finding and Recommendation**

The Commission should maintain its national list of Unbundled Network Elements and endorse a regulatory policy of enabling state public utility commissions to conduct the factual inquiries on a market by market basis, which will determine whether it is necessary to add or delete network elements from its national UNE list at TELRIC pricing.

The states are properly the venues for consideration of the competitive or anti-competitive availability of network elements, of impairment and other fine measures, which are within the competencies of state public utility commissions to evaluate and upon which to rule. California, New York and New Jersey are setting wholesale access prices at points, which permit competitive entry and markets to emerge. Under no circumstances should the FCC hinder these and other state commissions, which are just now beginning to achieve success in opening local markets.

Separately, the Commission is wise to appeal the Appeals Court panel's decision in the *USTA* ruling for an en banc review at the Appeals Court to sustain its congressionally delegated authority to manage network elements. In its desire to effect agency competence, the three judge panel at the Appeals Court has overreached, interposing its judgment on the expert agency's, to the detriment of the Commission's discretionary authority. Indeed, it is anomalous that the USTA panel based so much of its ruling in apparent disregard for the 7-1 Supreme Court ruling in *Verizon*.

## **Context**

In many ways, the timing of the Commission's triennial review (CC Docket Numbers 01-338, 96-98 and 98-147) could not prove more propitious.

This past May, the Commission received broad endorsement from the Supreme Court for its TELRIC (total element long run incremental cost of an element) pricing methodology (*Verizon v. FCC*, 535 U.S.      slip opinion) and its exercise of its congressionally delegated authority and the Commission received further direction from the United States Court of Appeals that its policy concerning Unbundled Network Elements (*United States Telecom Association v. FCC* (00-1012) requires greater specificity and consideration of pertinent local conditions.

While the *USTA* court overreached in predetermining the factors that it deemed must be considered in reaching an impairment decision, its conclusion that most of those facts lie in states and may significantly differ from state to state is valid.

Taken together, both rulings provide the Commission with a strategy to discern and a road map with which to navigate a feasible route toward and through the highly complex regulatory issue of unbundled network elements and their pricing.

Concerning TELRIC pricing, the Court unambiguously endorsed the forward looking cost of providing network elements and rejected historic cost based on rate of return or other pricing methodologies. "A merchant asked about the 'cost' of his goods may

reasonably quote their current wholesale market price, not the cost of the items on his shelves, which have bought at higher or lower prices.” (*Verizon v. FCC*, slip opinion, p.3)

Justice Breyer dissented. While agreeing with the majority that the Telecommunications Act of 1996 does not require historical pricing, the Justice favors a “less formal kind of ‘play it by ear’ system,” (Opinion on Justice Breyer, slip opinion, p.21) which he discerns inappositely in European telecommunications policy, enabling greater regulatory flexibility, yet undiminished regulatory authority, in wholesale pricing and network elements.

The Appeals Court addresses and elaborates Breyer’s point of view concerning the scope of unbundled network elements in *USTA v. FCC* (00-1012) by citing extensively from his concurring opinion from an earlier case *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999). Much of the rationale that Breyer had used in that *Iowa* concurrence had turned into a dissent in the 7-1 *Verizon* Supreme Court ruling only a week earlier when the majority soundly rejected Breyer’s arguments. Nonetheless, the Appeals Court panel appeared to favor Breyer’s ‘play it by ear’ approach.

In so many words, the Appeals Court indicates that it wishes to ‘play it by ear’ when it comes to the range of Unbundled Network Elements. Like Justice Breyer in his dissent in *Verizon*, the Appeals Court favors a less prophylactic national regime. It comes out for deleting one or two of the network elements from the current roster. It demands greater

consideration to local conditions in determining the impairment competitors endure in their efforts to enter markets dominated historically by monopoly Bell company providers.

The Appeals Court falls on the side that less unbundling is better for competition and that grater unbundling will deter investment. Both of those arguments were expressly rejected by the *Verizon* Court.

With such instructions from the Supreme Court and the Appeals Court for the District of Columbia, the Commission should now maintain its national list of Unbundled Network Elements and endorse a regulatory policy enabling state public utility commissions to conduct the factual inquiries on a market by market basis, which will determine whether it is necessary to add or delete network elements from its national UNE list at TELRIC pricing. Any number of states endorsed such a course of action prior to the Appeals Court ruling in their comments in this proceeding.

Clearly, it is impossible for the expert regulatory agency to administer communications industries and public policy ‘playing it by ear.’ Doing so only invites further intrusions on the Commission’s discretionary authority based on inescapably arbitrary and capricious rule-makings resulting from such a tonal approach.

For the FCC to now launch on a course of ever more granular metrics to create models for impairment would overburden its resources in an effort to yield the specificity demanded of the Appeals Court. So doing would neither palliate the Appeals Court nor

provide the predictability demanded of incumbents and competitors nor assure the certainty demanded by investors.

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## **Comments**

Of the many scholars, who study telecommunications, perhaps William J. Baumol articulates the issue of local phone competition most cogently. The policy issue, Baumol observes, is "an imposed access requirement, forcing the incumbent monopolist to rent access to its facilities to those who desire to compete. But, this is a real solution only if something is done about the price of entry. Otherwise, the incumbent can still protect

itself by erecting an artificial barrier in the form of excessive access fees. Of course, as with any price, an imposed access charge can also be damaging to welfare if it is set too low, because that only invites entry by inefficient competitors, who then are, in effect, granted a suicidal subsidy by the incumbent.”<sup>1</sup>

As one of the proponents of TELRIC pricing, Baumol’s observation repays attention, because incumbents remain obdurate about access. From enactment of the Telecommunications Act through July, 2002, regional phone companies have incurred more than two billion dollars in fines for failing to comply with the Act or other failings. The following roster tallies fines incurred by former Bell regional operating companies:

SBC: \$1,040,000,000  
Verizon \$303, 000,000  
Qwest: \$879,000,000  
Bell South \$20,000,000  
  
Total: \$2,242,000,000<sup>2</sup>

It would be unwise, therefore, to authorize ILEC/RBOC discretion over wholesale UNE pricing, for the Bell companies have consistently demonstrated obduracy in meeting their obligations under the Act.

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<sup>1</sup> McKnight, Vaaler and Katz, editors, *Creative Destruction*, 2001, p.30

<sup>2</sup> Wall Street Journal, Bloomberg, Communications Daily, Grant Forks Herald, The Tennessean, ePrairie.com, Chicago Sun Times, SBC.com, Reuters, Los Angeles Times, Detroit Free Press, TRInsight, AP, DSL Prime, Oregonian, The Patriot News, Dow Jones, Tampa Tribune, Chicago Tribune, Fort Worth Star Telegram, Dayton Daily News, Illinois Commerce Commission, Indiana Utility Regulatory Commission, Public Utilities Commission of Ohio, Palm Beach Post, Michigan Public Services Commission, The Atlanta Journal and Constitution, Wisconsin Public Service Commission, Rocky Mountain News, The Arizona Republic, Albuquerque Journal, South Bend Tribune, The Indianapolis Star, Crain’s Detroit Busiess, Telephony, The Virginian-Pilot, St. Paul Pioneer Press, National Association of Attorneys General Consumer Protection Report, Akron Beacon Journal, San Francisco Business Times, The Tucson Citizen, San Antonio Express News, The Sun Herald – Biloxi, San Jose Mercury News, San Diego Business Journal, Wisconsin State Journal, Newsday, The Cleveland Plain Dealer, the FCC.

RBOC obduracy repays attention, because the extensive news reporting and real commercial disruption surrounding the collapse of Worldcom and of pending bankruptcies of some competitive local exchange carriers could lead regulators to place disproportionate emphasis on ‘irrational exuberance’ or ‘infectious greed’ on the parts of those investing in and operating competitive new entrants following enactment of the Telecommunications Act. To be sure, news reports indicate wrong doing by some executives. Some analysts have found competitors entering markets, which could support smaller numbers of competitors, with the end results that some of those new entrants fail. However, crafting UNE and UNE-P policy without comparable emphasis on the obduracy of the RBOCs in enabling competitors to access network elements would be looking at only a portion of a more complex investment and operational history over the past six years.

It is in this regard that Baumol’s concern about ‘excessive access fees’ merits consideration for the unyielding posture of the RBOCs deferring access both has imposed and yet places costs on competitors in terms of their costs of capital and their capacities to offer services as the Act authorizes.

As to Baumol’s concern about a ‘suicidal subsidy,’ the *Verizon* Court addresses this point in its endorsement of TELRIC pricing. The legislative history of the Act, cited by the Court, indicates that incumbent phone companies “will have to allow for nondiscriminatory access on an unbundled basis to the network functions and services of

the Bell operating companies networks that is at least equal in type, quality, and price to the access a Bell operating company affords to itself.” (slip opinion p. 16, citing 141 *Congressional Record* 15572 (1995) ). The TELRIC pricing regime followed in due course to emulate the prices that would result in a competitive wholesale market. It made more sense to devise such access pricing on the basis of current rather than historic costs of network building due to the absurdity of setting wholesale access prices for network elements in the present and future based on costs for anachronistic equipment that would not be employed by an incumbent or new entrant. TELRIC pricing assumes existing switch locations and existing routes between those locations and customers; TELRIC is fully compensatory based upon contemporary equipment affording the greatest efficiency. For new investment, TELRIC closely approximates actual cost plus profit.

Indeed, ‘suicidal subsidy’ in terms of UNE or UNE-P and TELRIC pricing could receive traction only if the Commission were to buy into RBOC claims that lost opportunity costs of permitting new entrants to vie for their once captive customers represents a cost they should not have to endure. In effect, the RBOCs wish to inflect the Commission to permit them to impose retail prices as wholesale prices due to lost opportunity costs for not garnering retail revenues, which competitors win.

The RBOC position of ‘below cost’ concerning their characterizations of TELRIC pricing actually amounts to a claim that RBOCs can no longer extract the same level of revenues on a per customer basis in competitive local markets as they would under a now impermissible monopoly regime.

Such a line of reasoning now emerges on the part of the RBOCs to step back from competitive local phone markets. It is, of course, the obverse of earlier declarations concerning competition in the run up to the Act, and should be regarded as such.

Should the RBOCs prove to be successful inducing the Commission to acknowledge their lost opportunity costs for holding on to a monopoly that is no longer permitted, so doing would amount to a regulatory thermidor terminating competitors prior RBOC acquisition of 271 permission to enter long distance markets and thereby successfully managing the regulatory process to benefit of their corporate interest, but to the detriment of competitive markets and to the public interest.

Comparably disturbing is the RBOC contention, following on the New York ruling, that natural monopoly in network elements now renders competition as inefficient. This rhetoric, following on the competitive rhetoric in the mid-nineties, is worthy of Emile Zola's treatment of the French political and military establishment in *J'Accuse*<sup>3</sup> for its self-serving purposes and opportunism. The Act, which the RBOCs supported at the time, permitted competition in network elements in order to stimulate investment and innovation. To now argue that competition is inefficient just as regulators in New York, California and New Jersey are beginning to set wholesale access prices so that competitive entry can grow from five or six percent of market share for residential customers into vibrant competitive markets, makes Major Ferdinand Walsin-Esterhazy look like Charles deGaulle.

There is nothing natural in network elements. There is much that is historic. And, there is much that took on the complexion of a natural monopoly in negotiations with the Wilson Government leading to the Kingsbury Commitment in 1916 in establishing a regulated monopoly for phone services in the United States with available technologies at that time. However, that complexion was as much a construction of AT&T and the Bell system as it was anything natural because AT&T at that period in time faced what would now be characterized as competition from over builders and it successfully negotiated its protected monopoly status in return for the promise of universal service. As legacies of that monopoly, the RBOC contention is halcyon and the Commission would wisely regard it so.

The challenge now is to enable competition utilizing network elements. The Commission does not need to fashion a more targeted approach to unbundling. TELRIC pricing and expansive unbundling realize the Commission's five factors of furthering goals of the Telecommunications Act, namely:

- rapid introduction of competition
- promotion of facilities based competition
- investment
- innovation
- reduced regulation
- market certainty
- administrative practicality

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<sup>3</sup> Emile Zola, "Letter to the President of the Republic," *L'Aurore*, January 13, 1898.

Following on the *USTA* Court, the Commission should adhere to its national list of Unbundled Network Elements and permit state petitioning to add or to delete elements on the basis of local conditions.

Until such a time as competitive markets exist, the national list, with state flexibility approved by the Commission, should remain public policy.

Vibrant intramodal competition for voice and packetized services is very much in the national interest in terms of national income and security. “Communications in the 21<sup>st</sup> century should be provided over multiple, and technologically differentiated, facilities based, redundant networks,” as FCC Bureau Chief Ken Ferree told the Power Line Communications Conference in December, 2001<sup>4</sup>. Such a vision cannot be realized without thoroughly competitive, intramodal residential phone markets.

To be sure, intermodal competition at some point in time may be a reasonable standard by which to determine market power and hence UNE unbundling obligations.

At this point in time RBOC shares of wireless traffic (through Verizon and Bell South and SBC’s ownership of Cingular) and technology limitations moot any serious consideration of wireless as a competitive alternative in assessing ILEC UNE obligations.

Cable telephony is yet immature as a viable inter modal competitor and power line communication is viable only in limited trials.

Similarly, third party intermodal wholesaling is not yet viable to enable sustainable competition to emerge.

While temporal boundaries are reasonable as a norm, their imposition is premature under in the conditions of market power well into the foreseeable future. UNEs are now much more a matter of state by state examination than any sunsetting that the Commission could contemplate. The states should set wholesale pricing policies for UNEs based on TELRIC models and their discretion should not be pre-empted through national standards or policy.

## **Conclusion**

The Commission should maintain its national list of Unbundled Network Elements and endorse a regulatory policy of enabling state public utility commissions to conduct the factual inquiries on a market by market basis, which will determine whether it is necessary to add or delete network elements from its national UNE list at TELRIC pricing.

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<sup>4</sup> Ken Ferree, Keynote Address, Power Line Communications Conference, December, 2001.

circumstances should the FCC hinder these and other state commissions, which are just now beginning to achieve success in opening local markets.

Separately, the Commission is wise to appeal the Appeals Court panel's decision in the *USTA* ruling for an en banc review at the Appeals Court to sustain its congressionally delegated authority to manage network elements. In its desire to effect agency competence, the three judge panel at the Appeals Court has overreached, interposing its judgment on the expert agency's, to the detriment of the Commission's discretionary authority. Indeed, it is anomalous that the USTA panel based so much of its ruling in apparent disregard for the 7-1 Supreme Court ruling in *Verizon*.